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Supreme Court of the United States

OCTOBER TERM 1963.

No. 928

LITCHFIELD SECURITIES CORPORATION,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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LITCHFIELD SECURITIES CORPORATION,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

Litchfield Securities Corporation prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in this case on December 5, 1963.

Opinions Below.

The opinion of the United States District Court is printed in Appendix 1 hereto, Page A-1, and is reported at 216 F. Supp. 801 (S. D. New York, 1963).

The opinion of the United States Court of Appeals is printed in Appendix 2 hereto, Page A-6, and is reported at 325 F. 2d 667 (2d Cir., 1963).

Jurisdiction.

The judgment of the United States Court of Appeals for the Second Circuit was entered December 5, 1963. Rehearing was denied on December 20, 1963.

Title 28, United States Code, Section 1254(1), confers on this Court jurisdiction to review the judgment of the United States Court of Appeals for the Second Circuit by writ of certiorari.

Questions Presented.

1. In determining "Undistributed Personal Holding Company Income", on which severe penalty taxes are imposed, Section 545(b)(5)(B) of the Code* directs that "taxes attributable" to net long-term capital gains be computed "without including" such gains in "taxable income". Should such gains be excluded from "taxable income" under Section 545(b)(5)(B), but included therein for computing the dividend received deduction under Section 246(b) of the Code?

2. Did the United States Court of Appeals for the Second Circuit commit error by failing to apply the rule that a penal tax statute (here imposing the personal holding company tax) must be strictly construed against the Government?

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* Statutory references, unless otherwise indicated, are to the Internal Revenue Code of 1954.

Statutes Involved.

Internal Revenue Code of 1954:

§63. *Taxable income defined*

(a) General rule.—* * * for purposes of this subtitle the term "taxable income" means gross income, minus the deductions allowed by this chapter, * * *.

§243. *Dividends received by corporations*

(a) General rule.—In the case of a corporation * * * there shall be allowed as a deduction an amount equal to 85 percent of the amount received as dividends * * * from a domestic corporation which is subject to taxation under this chapter.

§246.(b). *Limitation on aggregate amount of deductions*

(1) General rule.—* * * The aggregate amount of deductions allowed by sections 243(a), 244, and 245 shall not exceed 85 percent of the taxable income computed without regard to the deductions allowed by sections 172, 243(a), 244, 245, and 247.

§545. *Undistributed personal holding company income*

(a) Definition.—For purposes of this part, the term "undistributed personal holding company income" means the taxable income of a personal holding company adjusted in the manner provided in subsection (b), minus the dividends paid deduction as defined in section 561. * * *

(b) Adjustments to taxable income.—For the purposes of subsection (a), the taxable income shall be adjusted as follows:

(1) Taxes.—There shall be allowed as a deduction Federal income * * * taxes * * * but not including * * * the personal holding company tax imposed by

section 541, or the taxes imposed by corresponding sections of a prior income tax law. * * *

* * * * * * *

(5) Long-term capital gains.—There shall be allowed as a deduction the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, minus the taxes imposed by this subtitle attributable to such excess. The taxes attributable to such excess shall be an amount equal to the difference between—

(A) the taxes imposed by this subtitle (except the tax imposed by this part) for such year, and

(B) such taxes computed for such year without including such excess in taxable income.

* * * * * * *

§1201. *Alternative tax.*

(a) Corporations.—If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, then, in lieu of the tax imposed by sections 11, 511, 821(a) or (c), and 831 (a), there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

(1) a partial tax computed on the taxable income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and

(2) an amount equal to 25 percent of such excess. * * *

Statement of the Case.

This is a suit for refund of personal holding company tax paid with respect to Taxpayer's 1957 income. No facts are in dispute, and the controversy relates solely to a ques-

tion of construing Section 545(b)(5) of the Code. That section was added to the law in 1954, and (except for the District and Circuit Court decisions in this case) has never been construed by any Court.

Taxpayer was a personal holding company in 1957; its return as filed showed no personal holding company tax due. Upon audit, all information on the return was accepted without change, but the Internal Revenue Service issued a 30 day letter asserting a deficiency in personal holding company tax of $8,599.76. Taxpayer paid the asserted deficiency and timely filed a claim for refund; after the expiration of more than six months, without action thereon, this suit was instituted on August 11, 1960.

The issue here involves determination of the "taxes attributable" to long-term capital gains of a personal holding company for the purpose of arriving at "Undistributed Personal Holding Company Income", upon which a severe penalty tax is imposed. Before the '54 Code, personal holding companies were permitted, in computing income subject to the penalty tax, to deduct:

> (i) net long-term capital gains, in full, because the capital gains tax rate on individuals is no higher than it is on corporations, and personal holding company stockholders derive no advantage from realization of capital gains by their personal holding company; and
>
> (ii) federal income and excess profits taxes, in full, because amounts paid out in taxes do not remain in the corporate coffers, enriching the stockholders while escaping the graduated personal income tax rates.

By allowing full deduction for long-term capital gains and income taxes, the 1939 Code allowed a double deduction for the portion of the income taxes imposed on the capital gains. Congress sought to meet this problem, in Code §545(b)(5),

by limiting the capital gains deduction to net long-term capital gains less the taxes attributable to such gains.

The statute directs that taxes attributable to long-term capital gains be determined by computing Federal income taxes "without including" such gains "in taxable income" [545(b)(5)(B)]. The government and the courts below included long-term capital gains in taxable income in computing the dividend received deduction under Sections 243 and 246, but excluded such gains from taxable income in computing the tax thereon. Petitioner submits that this was error.

REASONS FOR GRANTING A WRIT

I.

The question here involved is important in the administration of the personal holding company provisions of the Code, as well as those relating to tax on unreasonable accumulation of surplus.

By definition, the bulk of personal holding company income is passive (dividends, interest, royalties, etc.). Thus, of necessity, the major portion of the assets of every personal holding company consists of capital assets. Realization of capital gains is both more frequent and more significant in the case of personal holding companies than in the case of other corporations.

If the formula approved by the Second Circuit for determining "taxes attributable" to long-term capital gains were to be applied to every personal holding company, uncounted millions of dollars would be exposed to the severe penalty tax on undistributed personal holding com-

pany income. In view of the uncertain tone of the decision of the Court of Appeals in this case (discussed *infra*, p. 8) counsel for many taxpayers would litigate the issue here involved, and thus proliferate controversy between taxpayers and the government. An authoritative decision by this Court on the issue would foreclose any such possibility.

In relevant part, section 535(b)(6) contains language identical to that involved in the instant case. Thus, in the determination of income subject to the accumulated earnings tax imposed by Section 531, there is an identical problem of statutory construction. An authoritative decision by this Court on the issue herein would similarly foreclose controversy and litigation in this area.

The foregoing considerations become increasingly significant in light of the extensive revisions to the personal holding company sections made in the Revenue Act of 1964. Section 225 of that Act incorporates the most extensive amendments relating to personal holding companies since the personal holding company tax became part of the law 30 years ago. Heretofore, a company did not become a personal holding company unless 80% of its gross income was personal holding company income (e.g., dividends, interest, royalties, etc.); under the new law, this ratio is reduced to 60%. Furthermore, the amount of non-personal holding company income required to keep a company out of the personal holding company category is significantly increased, since the new law generally requires reduction of such non-personal holding company income by the amount of expenses related thereto. As a result of these changes, a great many companies not heretofore subject to the personal holding company tax will be exposed thereto. This is a further reason for an authoritative interpretation by this court of the section here in dispute.

II.

The Court of Appeals failed to apply the rule that a penal tax statute must be strictly construed against the government.

A common reason for granting certiorari is a conflict in the decisions in the courts below. While no such conflict can here be shown, the decision of the Court of Appeals in this case clearly demonstrates that the court had serious doubts about the correct construction of the statute (325 F. 2d 670-71):

> "* * * Although this result [the one urged by the government] does not seem unreasonable, it does arouse wonder why, if that was the purpose, so elaborate a process must be performed and so many words used to describe it * * *" (bracketed words supplied).

And at page 671:

> "As is usual in tax cases, each side asserts that its construction accords with the 'plain meaning' of the statute and that its adversary's is in violent contradiction thereof. Although we would not think the latter accusation to be deserved here as to either party, the palm for the closer approach to the latter must go to the Commissioner. * * *"

The entire opinion lacks the measure of certainty which the nature of this case demands. This is no ordinary tax case; involved is a personal holding company tax, which is the most severely penal tax to be found in the entire Internal Revenue Code, with the single exception of penalties for fraud. In the opening sentences of its opinion, the Court of Appeals referred to personal holding company

taxes as "severe" (325 F. 2d 668). Such characterization is a euphemism, to say the least; a more accurate description would be "virtually confiscatory". The first $2,000 of undistributed personal holding company income is taxed at 75%, and the balance at 85%.

In the District Court opinion, Judge Dawson properly characterized the personal holding company tax as a "penalty for those who seek to incorporate their pocketbook to avoid surtaxes." Both Houses of Congress described the tax as a penalty tax; the House[1] and the Senate[2] Reports on the 1954 Internal Revenue Code used this identical language:

> "* * * Under present law cases of hardship frequently arise when a corporation rents property to its principal stockholders. Such rental income is treated as personal holding company income and the corporation may be subject to the *penalty tax*." (italics supplied)

The Court of Appeals for the Second Circuit in *Pembroke Realty & Securities Corporation* v. *Commissioner*, 122 F. 2d 252 (1941), similarly characterized the personal holding company tax as a "penal surtax" (page 253) and a "penalty tax" (page 254). Later, in *Aramo-Stiftung* v. *Commissioner*, 172 F. 2d 896 (1949), the same Court cited with approval, at page 897, a reference by the Court of Appeals of the District of Columbia to the personal holding company tax as a "penalty tax."

Ambiguities in penalty tax statutes must be resolved against the government. If this principle has any validity, or if its application is warranted in any circumstances, this

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[1] H. Rep. 1337, 1954 U. S. Code Cong. & Adm. News, vol. 3, p. 4081.

[2] Sen. Rep. 1622, 1954 U. S. Code Cong. & Adm. News, vol. 3, p. 4706.

is the case. In *Hatfried, Inc.* v. *Commissioner of Internal Revenue* (3rd Cir., 1947) 162 F. 2d 628, the court applied the acknowledged principle that, in the imposition of penalties, all doubtful questions must be resolved in favor of those against whom the penalties are imposed. The Court said, at Page 633:

> "Further, it is well-settled that in the application of penalties 'all questions in doubt must be resolved in favor of those from whom the penalty is sought.' *Crawford, Statutory Construction, Section 240, Page 462.*"

In *Acker* v. *Commissioner of Internal Revenue* (6th Cir., 1958), 258 F. 2d 568, aff'd. 361 U. S. 87, the following appears (at page 576):

> "It seems to us a policy of first order that taxpayers under this 'government of laws and not of men' be entitled to expect that whenever the Congress intends to exact a penalty for a particular omission, this will be done by *unequivocal language* embodied in a statute * * *" (emphasis supplied)

The opinion of this Court in the *Acker* case reiterates the principle (361 U. S. 87, 91):

> "We are here concerned with a taxing Act which imposes a penalty. The law is settled that 'penal statutes are to be construed strictly,' *Federal Communications Comm'n* v. *American Broadcasting Co.*, 347 U. S. 284, 296, and that one 'is not to be subjected to a penalty unless the words of the statute plainly impose it,' *Keppel* v. *Tiffin Savings Bank*, 197 U. S. 356, 362. See, e.g., *Tiffany* v. *National Bank of Missouri*, 18 Wall. 409, 410; *Elliott* v. *Railroad Co.*, 99 U. S. 573, 576."

The Court of Claims in *New Oakmont Corporation* v. *U. S.* (1949), 86 F. Supp. 897, repeated the well-settled principle in these words (at page 899):

> "* * * A taxpayer should not be subjected to a penalty unless he comes fairly clearly within the situation which is defined in the law as deserving to be penalized."

If further support be needed, 1 Mertens, Law of Federal Income Taxation 3.11 (1962 Revision), states the rule thus:

> "Where a statute imposes a tax which is in effect a penalty it is strictly construed and should not be extended to cover cases which do not fall within its letter. All questions in doubt must be resolved in favor of those from whom the penalty is sought."

The vacillating and indecisive decision of the Court of Appeals in this case creates a puzzle for the Bench and the Bar. Is it now the law that penal tax statutes will be resolved in favor of the Commissioner if his interpretation merits the "palm for the closer approach to the letter"? Has the rule requiring strict construction of penal statutes been abrogated? It is respectfully submitted that only an authoritative decision of this Court can resolve these doubts.

Conclusion.

The petition for a writ of certiorari should be granted.

Dated: March 16, 1964.

Respectfully submitted,

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APPENDIX 1.

Opinion.

LITCHFIELD SECURITIES CORPORATION,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

UNITED STATES DISTRICT COURT

S. D. NEW YORK.

MARCH 28, 1963.

McCANLISS & EARLY, New York City, for plaintiff. JOSEPH F. MONAGHAN, New York City, of counsel.

ROBERT M. MORGENTHAU, U. S. Atty. for the Southern Dist. of New York, for defendant. MORTON L. GINSBERG, New York City, of counsel.

DAWSON, District Judge.

This is an action to recover the sum of $8,599.76, plus interest, paid by the plaintiff corporation upon a deficiency asserted by the Commissioner of Internal Revenue for the taxable year 1957. Both sides have moved for summary judgment under Rule 56 of the Federal Rules of Civil Procedure. There are no material issues of fact in dispute and the controversy stems solely from conflicting interpretations of section 545(b) (5) (B)[1] of the Internal Revenue Code of 1954.

[1] "§ 545. Undistributed personal holding company income.

"(a) Definition.—For purposes of this part, the term 'undistributed personal holding company income' means the taxable income of a personal holding company adjusted in the manner provided in subsection (b), minus the dividends paid deduction as defined in section 561.

Opinion.

[1] Plaintiff corporation is a personal holding company as defined by section 542. As such, it is subject to corporate income tax and is, in addition, subject to a personal holding company tax. The personal holding company tax is designed as a penalty for those who seek to incorporate their pocketbook to avoid surtaxes.

In accordance with the expressed legislative intent, the tax upon undistributed income is exceedingly high: 75 percent of the first $2,000.00 and 85 percent of any excess. Section 545, which provides for a tax upon "undistributed personal holding company income," allows certain deductions of those items which would not aid the taxpayer in avoiding surtax on ordinary income. These may be classified as (1) dividends paid to the stockholders of the personal holding company; (2) payment of income taxes; and (3)

"(b) Adjustments to taxable income.—For the purposes of subsection (a), the taxable income shall be adjusted as follows:

"(1) Taxes.—There shall be allowed as a deduction Federal income and excess profits taxes (other than the excess profits tax imposed by subchapter E of chapter 2 of the Internal Revenue Code of 1939 for taxable years beginning after December 31, 1940) and income, war profits and excess profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 164(b)(6)), accrued during the taxable year, but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by corresponding sections of a prior income tax law. A taxpayer which, for each taxable year in which it was subject to the tax imposed by section 500 of the Internal Revenue Code of 1939, deducted Federal income and excess profits taxes when paid for the purpose of computing subchapter A net income under such Code, shall deduct taxes under this paragraph when paid, unless the taxpayer elects, in its return for a taxable year ending after June 30, 1954, to deduct the taxes described in this paragraph when accrued. Such an election shall be irrevocable and shall apply to the taxable year for which the election is made and to all subsequent taxable years.

long-term capital gains which would be taxed at a maximum of 25 percent whether in the hands of an individual or a corporation.

Section 545 sets forth the various deductions which a corporation is allowed in determining its personal holding company income. Subsection 1 allows as a deduction all federal income taxes paid, including any capital gains tax paid. Subsection 5 allows as a deduction the capital gain itself, less any tax attributable to the gain.[1] This subsection prevents the corporation from realizing a double deduction since the tax attributable to the gain has already been deducted by virtue of subsection 1.

[2] The sole issue raised by the instant motion is the ascertainment of the tax attributable to a capital gain of $48,410.14 realized by the plaintiff in 1957. Plaintiff's position is that the tax attributable to this capital gain is the difference in taxes it paid in 1957 and what it would have paid had it not realized the capital gain. The defendant asserts that the tax attributable to the capital gain is the difference between the tax imposed in 1957 and the tax which would have been imposed had the capital gain not been included in taxable income.

If it were not for the interaction of sections 243 and 246 (the Dividends Received Credit)[2] with section 545(b)(5),

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[1] "(5) Long-term capital gains.—There shall be allowed as a deduction the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, minus the taxes imposed by this subtitle attributable to such excess. The taxes attributable to such excess shall be an amount equal to the difference between—

"(A) the taxes imposed by this subtitle (except the tax imposed by this part) for such year, and

"(B) such taxes computed for such year without including such excess in taxable income."

[2] "§ 243. Dividends received by corporations

"(a) General rule.—In the case of a corporation, there shall be allowed as a deduction an amount equal to 85 percent

the methods of computation used by the parties would yield identical results.

Section 243 (Dividends Received Credit) allows as a deduction 85 percent of dividends received from other domestic corporations. Section 246 limits the amount of the deduction to 85 percent of taxable income. A corporation seeking a dividends received deduction is required to make two calculations: (1) 85 percent of dividends received that qualify under section 243; and (2) 85 percent of taxable income without regard to the deduction allowed by section 243. The lesser of the two amounts is then allowed as a deduction to the corporation.

The plaintiff, by realizing a long-term capital gain of $48,410.14 in 1957, was able to avail itself of the full deduction allowed by section 243. If it had not had that long-term capital gain, taxable income would have been reduced sufficiently to necessitate the lesser dividends-received credit allowed by section 246.

The plaintiff, in recomputing its entire 1957 corporate tax, has reduced its deduction for dividends received to the lesser amount allowed by section 246.

The defendant's position is that section 545(b)(5) requires the amount of the long-term capital gain to be included in all calculations which are necessary to derive taxable income. This would allow the plaintiff the larger deduction for dividends received by virtue of section 243. Taxable income of $51,153.36 would result. The amount of the long-term capital gain would then be deducted from

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of the amount received as dividends * * * from a domestic corporation which is subject to taxation under this chapter."

"§ 246. Rules applying to deductions for dividends received * * *

"(b) Limitation on aggregate amount of deductions.—

"(1) General rule.—Except as provided in paragraph (2), the aggregate amount of the deductions allowed by sections 243, 244, and 245 shall not exceed 85 percent of the taxable income computed without regard to the deductions allowed by sections 172, 243, 244, 245, and 247."

taxable income and a tax computed on the remaining balance. The amount of the tax, $822.97, would be subtracted from the actual tax imposed of $12,925.51 to determine the tax attributable to the capital gain. This method of calculation leaves the plaintiff with a deduction of $36,307.60. It is the long-term capital gain of $48,410.14 less the tax attributable to the gain of $12,102.54.

Section 545(b) (5) clearly sets forth the method to be employed in determining the tax attributable to a long-term capital gain. It is the difference between the tax as imposed and a tax on an amount equal to taxable income less the long-term capital gain. The tax as imposed is $12,925.51. Taxable income less the amount of the capital gain is $2,743.32. A corporate income tax on that amount would equal $822.97. Thus the tax attributable to the capital gain is $12,925.51 less $822.97, or $12,102.54. The deduction allowed by section 545(b) (5) is the long-term capital gain less the tax attributable to the gain. It is $48,410.14 less $12,102.54, or $36,307.60.

Section 545(b)(5)(B) states that the amount to be subtracted from the tax imposed is "such taxes computed for such year without including such excess in taxable income." "Such excess" refers to the long-term capital gain. This is precisely the method of computation utilized by the defendant. The amount of the capital gain is deducted from taxable income and a tax computed on the remaining balance.

The motion of plaintiff for summary judgment is denied. Defendant's motion for summary judgment is granted.

So ordered.

APPENDIX 2.

Opinion.

LITCHFIELD SECURITIES CORPORATION,
Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

No. 81, Docket 28290.

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT.

ARGUED OCT. 23, 1963.

DECIDED DEC. 5, 1963.

JOSEPH F. MONAGHAN, MCCANLISS & EARLY, New York City (JOHN F. WALSH, New York City, of counsel), for plaintiff-appellant.

ROBERT ARUM, Asst. U. S. Atty., ROBERT M. MORGENTHAU, U. S. Atty. for Southern Dist. of New York, for defendant-appellee.

Before LUMBARD, Chief Judge, and MEDINA and FRIENDLY, Circuit Judges.

FRIENDLY, Circuit Judge.

This appeal is by a personal holding company from an order of Judge Dawson in the Southern District of New York, dismissing its complaint in a suit for refund of a tax on undistributed personal holding company income. In determining the amount of such income, upon which severe taxes are imposed, 545(b) (5) of the Internal Revenue

Opinion.

Code of 1954, permits deduction of net long-term capital gains[1] after reduction of these by federal income taxes attributable to them. This suit requires interpretation of the statutory direction for calculating how much tax is "attributable" to the capital gains.

[1] Special provision for the taxation of personal holding companies began with §351 of the Revenue Act of 1934, 48 Stat. 751. The object was "to devise a tax which would be levied automatically against corporations coming within the definition * * * without the necessity of proving a *purpose* of avoiding income taxes on the shareholders." 7 Mertens, Law of Federal Income Taxation, §40.02 (1956). The device used by Congress was a high tax rate on "Undistributed personal holding company income," this "pressure" rate being intended "not so much to produce revenue as to cause an abandonment of the use of personal holding companies * * *." Id. §40.03. The definitions of "undistributed personal holding company income" have varied. Section 545(a) of the 1954 Code, here applicable, defines this as "the taxable income of a personal holding company adjusted in the manner provided in subsection (b), minus the dividends paid deduction as defined in section 561."

Three adjustments provided in §545(b) for determination of undistributed personal holding company income are important in this case. Paragraph (1) allows deduction of "Federal income and excess profits taxes"; this is because amounts paid out in taxes do not remain in the corporate coffers, enriching the stockholders while escaping the graduated personal tax rates. Paragraph (3) disallows "the special deductions" for intercorporate dividends received, provided in various sections of the Code; allowance of any such deduction would frustrate one of the prime purposes

[1] *Since the taxpayer here had no short-term capital losses we* shall sometimes refer, as we do in this instance, simply to Litchfield's net long-term capital gains rather than use the full statutory phrase—"the excess of the net long-term capital gain * * * over the net short-term capital loss."

of the tax, namely, to prevent what in substance is dividend income of individuals from escaping surtaxes. Paragraph (5) reads as follows:

> "(5) Long-term capital gains.—There shall be allowed as a deduction the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, minus the taxes imposed by this subtitle attributable to such excess. The taxes attributable to such excess shall be an amount equal to the difference between—
>
> "(A) the taxes imposed by this subtitle (except the tax imposed by this part) for such year, and
>
> "(B) such taxes computed for such year without including such excess in taxable income."

The rationale of this is that, the capital gains tax rate on individuals being no higher than it is on corporations, the stockholder derives no tax advantage from realization of such profits through the corporation, but that, since 545(b)(1) already provides for deduction of all federal income taxes paid, the corporation would be permitted in effect to deduct the amount of its capital gains tax twice unless the deduction was reduced by the taxes "attributable" to such gain as defined in the second sentence of 545(b)(5), the subject of this controversy.

For 1957 the taxpayer, Litchfield Securities Corporation, reported taxable income of $51,153.36, as follows:

INCOME:		
Dividends from Domestic Corporations	$249,920.48	
Dividends from Foreign Corporations	$ 10,650.00	
Net Long Term Capital Gain	$ 48,410.14	
Total Income		$308,980.62

DEDUCTIONS:		
Salaries and Other Expenses	$ 45,394.85	
Deduction for Dividends Received	$212,432.41	
Total Deductions		$257,827.26
TAXABLE INCOME		$ 51,153.36

On this it computed its income tax as $12,925.51. It did this, under the "Alternative tax" provision of §1201(a), by applying to the net long-term capital gains, $48,410.14, a 25% tax rate, resulting in a tax of $12,102.54, and adding "a partial tax" on "the taxable income reduced by" the net long-term capital gains, to wit, $2,743.22, computed at the 30% rate that would apply to corporate income in that range, or $822.97. Although admitting that it was a personal holding company, Litchfield reported no additional liability for tax on undistributed personal holding company income.

The Commissioner determined that Litchfield had undistributed personal holding company income of $10,352.66 on which a personal holding company tax of $8,599.76 was due. Having paid this with interest and having been denied a refund by the Commissioner, Litchfield sued the United States for a refund in the District Court.

[2] The Commissioner arrived at his determination of deficiency by the following computation:

Taxable Income for 1957	$ 51,153.36
Adjustments Required Under Section:	
545(b)(1)—Corporate Income Taxes for the Year 1957	($ 12,925.51)

545(b)(3)—Disallowance of dividends received deduction allowed to Taxpayer in Computing Corporate Income Taxes		$212,432.41
545(b)(5)—Net Long Term Capital Gain minus Taxes Attributable thereto:		
Net Long Term Capital Gain	$48,410.14	
Less: Taxes attributable thereto	*$12,102.54*	*($ 36,307.60)*
Taxable Income as Adjusted Under Under Section 545(b)		$214,352.66
Less: Dividends Paid Deduction as Determined Under Section 561		($204,000.00)
TOTAL UNDISTRIBUTED PERSONAL HOLDING COMPANY INCOME AS DETERMINED UNDER SECTION 545		$ 10,352.66

The dispute relates to the item of $12,102.54 determined as taxes attributable to net long-term capital gains under §545(b)(5) which we have italicized; Litchfield asserts this should be only $1,641.81. Since the difference of $10,460.73 between the Commissioner's figure and Litchfield's exceeds the amount of undistributed personal holding company income which the Commissioner claimed, it follows that if Litchfield were right in this assertion, it would also have been right in reporting no personal holding company tax liability. We agree with Judge Dawson's well considered opinion that Litchfield was wrong.

The last sentence of §545(b)(5) defines the tax attributable to net long-term capital gain as the difference between two numbers, "(A) the taxes imposed by this subtitle (except the tax imposed by this part) for such year, and (B) such taxes computed for such year without including

such excess [capital gain] in taxable income." The Commissioner and Litchfield agree that here "(A)" is $12,925.51. The issue thus comes down to the determination of "(B)." Section 63(a) defines "taxable income" as "gross income, minus the deductions allowed by this chapter [ ]." Going to Litchfield's tax return with this definition in hand, the Commissioner found that "taxable income" was $51,153.36, from which he excluded "such excess," i.e., the net long-term capital gains of $48,410.14, resulting in a reconstructed taxable income of $2,743.22. The tax thereon would be $822.97, which the Commissioner determined to be the "(B)" figure. (A) minus (B) thus equalled $12,102.54. As is apparent, this was, in substance, the same process used by Litchfield in computing the alternative tax under §1201(a), and the sum determined by the Commissioner as "[t]he taxes attributable to such excess" was identical with the 25% tax on capital gains provided by §1201(a)(2). In a case like this, the Government's position thus is simply that "The taxes attributable to such excess" under §545(b)(5) are the same as the 25% tax levied thereon by §1201(a)(2). Although this result does not seem unreasonable, it does arouse wonder why, if that was the purpose, so elaborate a process must be performed and so many words used to describe it. The Government has an answer for this puzzlement; we will state it later.

Litchfield's position that the tax attributable to the net long-term gains was only $1,641.81 rests on the basis that if the net long-term gains had not been realized, taxable income would have been $32,276.34 rather than $2,743.22, with a resulting tax of $11,283.70. It defends this position by reading "(B)" to require recomputation of taxable income for the year as if no capital gain had been realized, rather than mere reduction of the already ascertained taxable income by excluding the amount of the capital gain. This distinction becomes important for the reason that if Litchfield had realized no capital gain during the year, it would not have been entitled to so large a dividends-received deduction in the computation of its taxable income. For the General Rule governing this deduction, announced

in §243(a) of the Code, whereby a corporation may deduct 85% of the amount received as dividends from domestic corporations, is qualified by §246(b)(1) so that, with an exception not here material, such deduction may not exceed 85% of the taxable income (computed without regard to the dividend received deduction). Since, in the absence of the net long-term capital gains, taxable income before the dividends received deduction would have been only $215,175.63,[2] the deduction would have been limited to 85% of that amount, or $182,899.29, rather than the $212,432.41 actually taken—with a corresponding increase in taxable income and tax thereon. In ordinary English the taxpayer's position is that to the extent that its net long-term capital gains simply enabled it to get the advantage of the full dividend received deduction, no taxes were attributable to the gains; its argument is that if taxes are to be computed "without including" capital gains, the gains must be excluded from every phase of the computation of taxable income.

As is usual in tax cases, each side asserts that its construction accords with the "plain meaning" of the statute and that its adversary's is in violent contradiction thereof. Although we would not think the latter accusation to be deserved here as to either party, the palm for the closer approach to the letter must go to the Commissioner. "Taxable income" is the gross income "minus the deductions allowed by this chapter," and $212,432.41 of dividends received deductions were in fact "allowed." Section 545(b)(5)(B) did *not* say "such taxes as they would have been computed for such year if such excess had not existed"

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[2] The computation is:

Total Income as Reported	$308,980.62
Less: Net Long Term Capital Gain	48,410.14
	$260,570.48
Less: Salaries and Other Expenses	45,394.85
	$215,175.63

—which, we diffidently suppose, would be a suitable rendering of Litchfield's position into tax English. Litchfield's claim also seems inconsistent with what we know to be the position of Congress on a related matter. By the Act of January 28, 1956, 70 Stat. 8, dealing with taxable years beginning after December 31, 1951, and before January 1, 1954, Congress directed, *inter alia*, that the exclusion of the excess of net long-term capital gains over net short-term capital losses from net income in the computation of the "partial tax" provided in §117(c)(1)(A) of the 1939 Code as amended by 56 Stat. 843 (1942) (the equivalent of §1201(a)(1) of the 1954 Code), should not reduce the dividends received credit. The Internal Revenue Service adopted this as its policy for years governed by the 1954 Code Rev. Rul. 56-151, 1956-1 Cum. Bull. 382, subsequently embodied in Treas. Reg. §1.1201-1, and the Court of Claims later held this construction to have been required by the 1939 Code apart from the 1956 legislation. Pitcairn Company *v.* United States, D. C., 180 F. Supp. 582 (1960). The theory advanced by Litchfield as to §545(b)(5)(B) has thus been authoritatively rejected as to §1201(a)(1); if it had not been, Litchfield could not profit from its argument in any event since the very computation here relied on to increase "(B)" would have increased "(A)" by the same amount.[3]

[3] See also Delaware Realty & Investment Co. *v.* Commissioner, 234 F. 2d 911 (3 Cir. 1956), and Bessemer Sec. Corp. *v.* United States, 314 F. 2d 521 (Ct. Cl. 1963). The issue in these cases arising under the 1939 Code, was whether the taxpayers, both personal holding companies, were entitled to a credit for a carry-over of dividends paid in excess of "Subchapter A net income" (personal holding company net income) in a prior year. The taxpayers' position depended on the validity of their assertion that capital gains excluded from Subchapter A net income for the purpose of the tax under §117(c)(1) must be excluded from such income for all purposes. Both courts held that computation of the capital gain tax at the alternative rate provided by §117(a)(1) rather than at the Subchapter A rate did not reduce the amount of Subchapter A net income for calculating the dividend paid.

[3] Relevant legislative material concerning the 1954 Code reinforces our conclusion as to the correctness of the Government's position. Under the 1939 Code as amended in 1942, the excess of net long-term capital gains over net short-term capital loss had been specifically excluded from the personal holding company tax where the alternative tax provision of §117(c)(1) applied, yet §505(a)(1) allowed deduction from personal holding company income of all federal income taxes paid. The House Report which accompanied the bill, H. R. 8300, ultimately enacted as the 1954 Code, announced that in this respect the bill "prevents the double benefit which may be obtained under existing law." 1954 U. S. Code Cong. & Adm. News, Vol. 3, p. 4082. H. R. 8300 accomplished this by excluding from the deduction for taxes in §545(b)(1) "the alternative capital gains tax determined under Section 1201(a)(2)," while allowing deduction of the entire excess of net long-term capital gain over net short-term capital loss, §545(b)(5). Litchfield concedes that the House bill would have led to the result here reached by the Commissioner. The language as enacted represents a change made by the Finance Committee of the Senate. Its report stated that "The committee made only technical changes in this section [§545]. These include * * * provision for the deduction of any alternative tax paid as a tax rather than as part of the capital gain deduction * * *." 1954 U. S. Code Cong. & Adm. News, Vol. 3, p. 4707. The more detailed statement relating to §545 said:

> "Under present law, the alternative capital gains tax is imposed in lieu of the income and personal holding company taxes. This adjustment reaches the same result. A technical amendment by your committee to the House bill allows the capital gains tax as a deduction in computing undistributed personal holding company income but reduces the amount of the deduction for capital gains by the taxes attributable to such gains." *Id.* 4961.

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The need for the "technical amendment," using so many more words than the House bill, arose, as the Government tells us, from the fact that the alternative capital gains tax provided by § 1201(a)(2) was applicable only if that tax was less than a tax otherwise computed, and it would not be less when deductions exceeded income other than the excess of net long-term capital gains over net short-term capital losses. In such cases—rather rare, one would suppose, for personal holding companies—the House bill would have had the effect of still allowing deduction of the entire amount of the gain plus the entire tax. We think it plain from the history that in the effort to prevent the double deduction which the House bill would have permitted in these unusual cases, neither the Senate nor the House by acquiescing in the Senate's amendment had any purpose to enlarge the deduction to which the House bill confined personal holding companies in the usual case. Litchfield's claim that such a resort to legislative history runs counter to C. I. R. v. Acker, 361 U. S. 87, 93, 80 S. Ct. 144, 4 L. Ed. 2d 127 (1959), is unsupportable. In cases too numerous for citation the Supreme Court has looked to such history for help in choosing between two readings of a statute which were equally permissible as a matter of language; here we are taking the smaller step of utilizing the history only to make certain that in applying the strict letter of what Congress said we are not doing violence to what it meant.

Affirmed.